

From: Rathgeber, Lisa <lisa.rathgeber@lehman.com>
Sent: Monday, February 26, 2007 6:25 PM (GMT)
To: Shotton, Paul <paul.shotton@lehman.com>
Subject: RE: Revised VaR Report
Attach: var detailed comments as of 0223.doc

Paul,

Below are my comments on the audit points (included in the attachment).
Point #2 under aggregation I believe you were going to re-write so I left it open. The items for Prasad I sent directly to him.

Data Capture - Control Concerns

Point #1

Based on our sample of feeds reviewed, we did not find adequate controls in place around feeds received by LehmanRisk and FI Risk. Although controls exist within the feeds to identify when the complete population of trades has not been received, we noted that there is no formal follow up process in place to research and resolve breaks identified.

Additionally, although the Division currently utilizes position/account level reconciliations, backtesting and exposure reviews with the business to provide assurance as to the validity of data used in LehmanRisk calculations there is no formalized/automated review of the data elements captured. The feeds into LehmanRisk need to be formally validated to enable the Division to demonstrate that appropriate data elements are captured to calculate VaR.

Action Plans:

1. Market Risk Managers will identify the key attributes of individual feeds to be used in the development of IT specifications to establish a formal automated review of LehmanRisk data capture. Date: April 30, 2007

2. Risk Technology will spec out automated reporting to formalize the review of data capture within LehmanRisk. This spec will include time to completion of actual reporting at which time we anticipate the date of this audit point will be changed to reflect the completion of the report and the ensuing review. Date: June 30, 2007

Methodology - Control Concerns

Point #1 - To be removed

Point #2 - Should be Control Enhancement

Our review of the VaR model documentation identified instances where changes/enhancements to the model in production preceded the update of the relevant documentation. Additionally, we noted that the VaR aggregation methodology for all products is not formally documented.

Action Plans:

Annual reviews of all Divisional policy and methodology documents are performed. The FY 2007 reviews will be conducted to ensure that all

material aspects of the models as well as all relevant aggregation issues are incorporated into the documents, as necessary. Models for which we roll out changes or enhancements in between document review periods will be identified on the Divisions documentation website to alert users of potential pending changes to the existing documents.
Date November 30, 2007

Point #3 - To be removed

Aggregation - Control Concerns

Point #1 -

At the time of our review, the VaR aggregation process was manually intensive, and as such, did not provide assurance over completeness and accuracy.

Action Plan:

Automation of the VaR aggregation process has been implemented. Date:
n/a

Point #2

To Be re-written by Paul

Governance - Control Concerns

Point #1 - to be removed

Point #2 - to be removed

Backtesting - Control Concerns

Point #1 - to be removed

Point #2 - n/a not risk

Limit Monitoring - Control Concern

Point #1 -

According to the Limit Policy, Risk Management is responsible for maintaining documentation for all current limits, limit changes, limit breaches and the course of action taken in respect of all breaches. At the time of our review we noted that there were instances where there was insufficient documentation of the action taken for several limit breaches and that there was no commentary on the aggregated Firm-wide limit breach.

Action Plan:

A formal process is in place to document all limit breaches, the actions taken in response to the breach. There is also a daily report for senior management which provides commentary on aggregated Firm-wide limit exposures and breaches, if relevant. Date: n/a - completed

Technology - Control Concern

Point #1 -

During our review we noted that in certain circumstances (e.g. when there is no front end system) the Division utilizes spreadsheets to calculate VaR rather than these calculations taking place within the LehmanRisk engine. At the time of our review this situation existed for

the Energy and Muni businesses

Action Plan -

From time to time the Division will utilize spreadsheets where the business systems do not enable us to use the LehmanRisk engine for VaR calculations. Since the time of the review the VaR of the Muni business is now calculated within LehmanRisk. The Energy business will be included within LehmanRisk once the businesses system enable us to do so. Date - n/a - dependent upon business

Point #2

Although there is a disaster recovery plan in place for the Division, this plan is not adequately documented. Additionally, the current plan provides for restoration of data to take 1 day. Data is backed up daily as part of the Firm's overall disaster recovery plan.

Action Plan -

At this time the benefit of having instantaneous data restoration does not outweigh the costs of hardware, storage, etc. The Firm feels that a 1 day lag in restoration is acceptable at this point in time.

Date - n/a

Point #3 -

OPEN - prasad to re-write.

Point #4 -

OPEN - prasad to confirm this is incorrect

Point #5 -

OPEN - prasad to confirm

VaR Reconciliation - Control Concern

Point #1 - Paul Shotton to be removed from list of owners

Point #2 - n/a not risk

Governance - Control Enhancement

Point #1 - to be removed

Technology - Control Enhancement

Point #1 - Prasad to supply action plan

VaR Reconciliation - Control Enhancement

Points #1 - 4 - n/a not risk

Point #5 - IAD to provide details

Point #6 - 7 - n/a - not risk

From: Tringali, James
Sent: Friday, February 23, 2007 4:42 PM
To: Rathgeber, Lisa
Subject: Revised VaR Report

Attached is the updated draft report in Word so you can add the action plans. I left in the current plans so you can just add and delete where appropriate. I made most of the changes we discussed with the following exceptions:

- methodology comments - pending further discussion with PWC and Beth
- London comments regarding FSA requirements for stress scenarios (Methodology #3) and Corp Governance - need to make sure Julian is OK with these
- Pathfinder - need to discuss with Beth
- Backtesting - have some additional questions and documentation to discuss
- VaR Rec - working with Mike Bishop to clarify what the status and what is priority.

Finally, IT Audit is gathering the documentation to support the "large number of individuals" access issues. I'll forward as soon I receive it.

Thanks,
Jim